Summary of Business Rule for Group or Composite Depreciation

Background

In the Congressional budgetary appropriations process, a single budgetary procurement line[1] may be used to acquire a number of different, but similar, end items. To illustrate, a single procurement line may be used to acquire a "family" of construction equipment, such as bulldozers, scrapers, and excavators. Some items may meet or exceed the Department of Defense (DoD) capitalization threshold for military equipment, while other items may not. Items acquired under a single procurement line may be recorded as individual items in a property system (without cost details) for accountability purposes, but often the total acquisition cost of the procurement line, rather than the acquisition cost of the individual items, is recorded in an accounting system.

Issue

The ME valuation methodology identifies program expenditures, using an automated approach, and associates these expenditures with the items being acquired. The objective is to link the expenditures directly to individual items. However, current Department accounting systems do not always support item level valuations. To address this, the Department was required to develop an approach for valuing multiple items acquired under a single procurement line.

Approach

The Statement of Federal Financial Accounting Standards (SFFAS) No. 23, *Eliminating the Category National Defense Property, Plant and Equipment (PP&E),* amends SFFAS No. 6 *Accounting for Property, Plant and Equipment*, to include the following language, "A composite or group methodology, whereby the cost of PP&E are allocated using the same rate, is permissible."

The related footnote states, "The composite methodology is a method of calculating depreciation that applies a single average rate to a number of heterogeneous assets that have dissimilar characteristics and services lives."

Until systems and processes are in place to establish, maintain and update the baseline value for multiple items acquired under a single procurement line, the Under Secretary of Defense (Acquisition Technology and Logistics) Property and Equipment Policy (P&EP) Office will continue to value these assets. The P&EP Office (with support from Component representatives) will work with the program management offices to execute this rule for valuing military equipment.

[1] The total of a procurement line is presented in Budget Exhibit P-1 (Procurement Line). Estimated cost and quantity data on end items that make up a procurement line are customarily provided in Exhibit P-40 (Budget Item Justification); in some cases, additional end item data is provided in Exhibit P-5 (Weapons System Cost Analysis).

As a basic rule, end items should be valued individually. The Department of Defense recognizes this objective and is developing the Capital Asset Management System – Military Equipment, Increment 2, to support the specific valuation and depreciation of individual items.

However, baseline data is not always available to value individual end items. Consequently, baseline valuation is limited to the level of available expenditure/financial data. To illustrate, if baseline expenditure data is available at the item level for the items that comprise the procurement line, the related items should be valued individually. If expenditure data is available only at the procurement line level, and if a determination can be made that some of the items have a unit cost that exceeds the capitalization threshold, then the entire procurement line should be valued as a single item purchase. The language in the accounting standards relating to Group and Composite depreciation supports this approach.

This rule for baseline valuations addresses the following four scenarios:

(1) Expenditure data is available only at the procurement line level and a determination has been made that **some** of the items being acquired under this procurement line have a unit cost in excess of the capitalization threshold;
(2) Expenditure and unique identifier data is available at the end item level, and **all** of the items in the procurement line have an estimated acquisition cost equal to or greater than the DoD capitalization threshold;
(3) Expenditure and unique identifier data is available at the end item level, and **some, but not all**, of the items in the procurement line have an estimated acquisition cost equal to or greater than the DoD capitalization threshold; and
(4) Expenditure and unique identifier data is available at the end item level, but **none** of the items in the procurement line have an estimated acquisition cost equal to or greater than the DoD capitalization threshold.

Scenario (1) – Expenditure data are available only at the procurement line level, and a determination has been made that **some** of the items being acquired under this procurement line have a unit cost in excess of the capitalization threshold.

- Value the entire procurement line as a single item.
- Program managers should provide a weighted average estimate of the useful lives of end items that comprise the procurement line for depreciation purposes.
- The weighted average should consider the relative cost and useful lives of the individual assets included in the procurement line item. For example, based on similarly valued assets, the weighted average would be computed by adding the engineering estimates of the useful lives of the individual assets included in the procurement line and then dividing the result by the number of items procured.
- Since there is no monetary value assigned to the items in this scenario nor is there a continuing parent-child relationship established between the items acquired and the program cost, the impact of asset disposal must be estimated using one of the following approaches;
    - If losses are generally in line with anticipated disposals, the program's military equipment value and related accumulated depreciation should be adjusted to reflect an estimate of disposals. Until more accurate information is available, this

estimate should be based on the amount of accumulated depreciation posted each year.

- In exceptional cases where significant and unanticipated losses occur, a write down based on a percentage of the loss compared to the remaining net book value of the related assets, should be recognized.

Scenario (2) – Expenditure and unique identifier data are available at the end item level and **all** of the items in the procurement line have an estimated acquisition cost equal to or greater than the DoD capitalization threshold.

- Value the end items in accordance with Baseline Valuation Methodology.
- Account for disposals in accordance with the Baseline Valuation Methodology.

Scenario (3) – Expenditure and unique identifier data are available at the end item level with **some** end items having an estimated acquisition cost equal to or greater than the DoD capitalization threshold and **others** have an estimated acquisition cost of less than the DoD capitalization threshold.

- For items with an estimated acquisition cost equal to or greater than the DoD capitalization threshold:
    - Value the end items in accordance with Baseline Valuation Methodology;
    - Account for disposals in accordance with the Baseline Valuation Methodology.
- For items with an estimated acquisition cost below the DoD capitalization threshold:
    - Expense items

Scenario (4) –**All** items in the procurement line have an estimated acquisition cost of less than the DoD capitalization threshold.

- Expense all items.